Editor's note: 97 I.D. 239 Petition for review by Director granted; Board decision reversed in part -- 9 OHA 68 (July 10, 1991) 98 I.D. 248

FOREST OIL CORP. (ON RECONSIDERATION)

IBLA 87-580 Decided September 26, 1990

Petition for reconsideration in part of decision in Forest Oil Corp., 113 IBLA 30, 97 I.D. 11 (1990).

Petition granted; decision reaffirmed.

1. Federal Oil and Gas Royalty Management Act: Royalties--Oil and Gas Leases: Royalties: Generally--Outer Continental Shelf Lands Act: Oil and Gas Leases

Although royalty underpayments are improper by definition and may, under some circumstances, subject the payor to civil and/or criminal penalties, the issue in the context of a royalty audit is what, if any, additional royalty is due and owing to the lessor. Where an audit is made of royalty payments for an oil and gas lease, underpayments disclosed by the audit are prop-erly offset by royalty overpayments on the same lease revealed within the period of the audit regardless of the fact that the underpayments were intended to recoup the prior overpayments.

APPEARANCES: Douglas B. Glass, Esq., Houston, Texas, for appellant; Howard W. Chalker, Esq., Peter J. Schaumberg, Esq., and Geoffrey Heath, Esq., Office of the Solicitor, U.S. Department of the Interior,

Washington, D.C., for the Minerals Management Service.

OPINION BY ADMINISTRATIVE JUDGE GRANT

Counsel for Minerals Management Service (MMS) has filed with the Board a Motion for Partial Reconsideration of the Board's decision in this case, cited as Forest Oil Corp., 113 IBLA 30, 97 I.D. 11 (1990). MMS seeks reconsideration on the issue of whether overpayments of royalty disclosed during the audit of an offshore oil and gas lease may be offset against royalty underpayments which resulted when the payor recouped the overpayments on subsequent monthly reports. Although the overpayments were not the subject of a formal refund request filed within 2 years of the payment, Forest has asserted the recoupments were filed within 2 years of the overpayment. MMS points out that the Board has upheld prior MMS decisions disallowing the taking of credit adjustments on Form MMS-2014 to offset past overpayments. It is asserted that such credit adjustments contravene the provisions of section 10 of the Outer Continental Shelf Lands Act (OCSLA), 43 U.S.C. § 1339 (1982), requiring formal application for a refund within 2 years of the overpayment. Concern is expressed by MMS that the result of our decision will be to encourage payors to unilaterally recoup overpayments without applying for refunds.

MMS seeks to distinguish this case from others where the Board has upheld the offsetting of overpayments against underpayments on a lease account during the period of the audit. It is contended those cases involved overpayments initially discovered during the audit. Petitioner argues the offset should be disallowed in this case on the ground that the overpayments were discovered by the payor within 2 years and were

the subject of subsequent unauthorized unilateral recoupment. Further, MMS contends that the prior practice of the Geological Survey (Survey) Conservation Division (the predecessor of MMS for royalty management functions) of allowing such adjustments on royalty reports during the time period covered by the Forest audit is irrelevant in light of our current understanding of the law. Accordingly, MMS asserts the Board erred in allowing the offset of the overpayments against the underpayments.

Forest has responded to the petition. Forest asserts that our decision in this case is not inconsistent with other audit cases involving the offset of overpayments against underpayments. The limitation of offsets to "unrelated" overpayments and underpayments argued by MMS is asserted by Forest to be unsupported by, and contrary to, past Board precedents.

An occasional byproduct of the decision of appeals on a case-by-case basis is that issues which are distinct but related will be approached from a somewhat different legal basis depending upon the characterization of the issue. This is the case with the issue of offsets within the framework of an audit as distinguished from the question of the allowance of unauthorized recoupment. This case provides the Board an opportunity to seek to reconcile these lines of precedent. We find it appropriate to grant the petition for reconsideration in order to clarify our holding herein.

In our prior decision in this case the Board analyzed the applicability of an offset to the audit in this case as follows:

With respect to the overpayments of royalty which were the subject of the subsequent alleged unauthorized recoupments taken by appellant on Form MMS-2014, we believe the precedents established in Mobil Oil Corp., 65 IBLA 295 (1982), and Shell Oil Co., [52 IBLA 74 (1981)], are relevant. In the lead case, Shell Oil Co., we dealt with the question of whether, in the circumstances of an audit of royalty payments on a lease account, overpayments disclosed in the audit may be allowed as an offset to underpayments disclosed in the audit notwithstanding the fact that the audit was conducted more than 2 years after the overpayment so that a refund would be barred by the terms of section 10 of OCSLA. The Board answered the question in the affirmative:

> Had Shell initiated a request in 1979 for a refund of its November 1974 overpayment, we believe Survey would have been correct in denying such request as untimely. In Phillips Petroleum Co., 39 IBLA 393 (1979), we so held. Where, however, Survey undertakes to audit a producer some 4 years after the payments at issue have been made, we hold that a sense of fundamental fairness requires Survey to recognize both a producer's underpayments and overpayments of royalty. We believe Survey should have properly offset Shell's underpayment by the amount of its overpayment. We do not believe that the 2-year period of limitations was established to give Survey a procedural advantage in computing royalty payments.

52 IBLA at 78. This precedent was further developed in Mobil Oil Corp., supra.

In the Mobil case the asserted overpayments which appellant sought to offset were discovered by the lessee rather than by Survey in the audit. The Board found this distinction immaterial: "The question then, is not whether the statute bars refunds or credits, but whether--assuming overpayments occurred--Survey should have recognized and offset these in the same audit period in which it discovered and assessed underpayment." 65 IBLA at 304. The Board answered this question in the affirmative and remanded the case to allow Survey to determine the extent of any allowable offsets. The scope of our holding was defined further by the concurring opinion wherein we recognized the past practice of permitting offsets and declined to invalidate this past practice:

> It is true that, in the past, Survey has permitted the offsetting of overpayments in one month by deductions from subsequent payments in future months. Our decision herein does not invalidate this practice. It does, however, properly limit it to the 2-year period mandated by 43 U.S.C. § 1339(a) (1976). In other words, where a lessee made royalty payments for any month in

> excess of that required by law, the excess may be deducted from future royalty payments provided that the excess payment occurred within 2 years of the future payment. Where, however, an excess payment has not been discovered within this 2-year period, such payment may not be recouped by diminution of future payments owing from production in the lease. Indeed, allowance of such deduction would be directly contrary to the 2-year limitation on refunds which Congress has expressly imposed. [Emphasis in original; footnote omitted.]

65 IBLA at 305-06 (Burski, A.J., concurring).

> Subsequently, MMS issued the Oil and Gas Payor Handbook * * *. Effective August 1, 1983, the Handbook was amended to specifically provide that a "payor cannot recoup an overpayment on an OCS lease through entries to Form MMS-2014 without receiv-ing prior approval from MMS." Payor Handbook Addendum No. 4, page 3 of 5 (July 1983); see 2 MMS, Royalty Management Program, Oil and Gas Payor Handbook § 4.4.2 (1986). In the absence of an MMS audit, the Board has upheld MMS decisions applying this provision to disallow recoupments of overpayments on Form MMS-2014 without prior authorization. [Footnotes omitted.]

113 IBLA at 43-45, 97 I.D. at 19-20.

The lead Board decision on the disallowance of unauthorized recoupment is Kerr-McGee Corp., 103 IBLA 338 (1988). In that case, a refund of royalty overpayments for gas produced from 1961 through 1970 resulting from a Federal Power Commission ordered refund to gas purchasers was requested in January 1978. The amount of the requested refund was deducted in the following month from royalty payments on the monthly report of sales and royalty. We expressly recognized the Solicitor's opinion concluding that the 2-year limitation on repayments applies to credits against future royalty obligations as well as to repayments. Refunds & Credits Under the Outer Continental Shelf Lands Act, Solicitor's Opinion, 88 I.D. 1090 (1981). Citing Mobil Oil Co., supra, the Board distinguished offsets involving

the credit of overpayments against past payments due within the period of an audit from the taking of a credit against future payments due which is governed by the 2-year limitation just as refunds are. 103 IBLA at 339. The Board found in the Kerr-McGee case that an offset was not involved. Rather, appellant followed an untimely refund request with an improper credit against current royalty due which was properly disallowed by MMS.

[1] We find the Kerr-McGee case is distinguishable from the present appeal in certain material aspects. The overpayments at issue in Kerr-McGee were the subject of a refund request filed more than 2 years after the overpayments and a subsequent unauthorized recoupment in the form of an underpayment on current royalty obligations. The underpayments by Forest came within 2 years of the overpayment which they were designed to recoup. Most significantly, both the under and overpayments fell within the timeframe of an MMS audit designed to ascertain the amount of royalty due and owing for that time period. The Board has upheld the view of the Solicitor and MMS that the recoupment of past royalty overpayments through applying a credit against current royalty obligations is a form of "refund" which may not be taken unilaterally, but which requires compliance with the procedures of section 10 of the OCSLA. 1/ Notwithstanding this principle, the purpose of a royalty audit is to ascertain the net amount of royalty due and owing to the United States. In resolving this issue it is necessary in the context of an individual lease to offset overpayments against underpayments

1/ Thus, the former Survey practice of allowing credit adjustments within 2 years, recognized in the concurring opinion in Mobil, has now been found improper.

within the timeframe of the audit. Although all underpayments are by definition improper, that fact provides no basis for ignoring the overpayments in determining the amount of the royalty due. The propriety of underpayments may be a proper issue in a civil penalty proceeding under section 109 of the Federal Oil and Gas Royalty Management Act of 1982, 30 U.S.C. § 1719 (1982), but this case does not involve a civil penalty.

We find this analysis to be consistent with the Solicitor's Opinion, supra, which specifically considered the question of offsets within the scope of an audit and the 2-year limitation. Citing with approval the Board's decision in Shell Oil Co., supra, the Solicitor found that section 10 of OCSLA permits offsetting (i.e., crediting of overpayments against past payments due) within the audit period. 88 I.D. at 1103. The Solicitor analyzed the applicability of the 2-year limitation to offsets within the timeframe of an audit in terms of the purpose of the statutory limitation. The opinion noted that the excess payments to be offset would not be withdrawn from the Treasury. Additionally, because offsets affect only past payments, they pose no threat to projected revenue estimates. Id. Further, the Solicitor held that the purpose of the limitation to protect against stale claims could hardly be invoked when the Department has already decided to shoulder the burden of reviewing monthly payments during the audit period. Id.

In a subsequent case, Santa Fe Energy Co., 107 IBLA 32 (1989), the Board expanded somewhat the Kerr-McGee precedent. We affirmed MMS orders requiring restitution of unauthorized credit adjustments on Form MMS-2014

notwithstanding the fact the underpayments sought to recoup prior royalty overpayments at least some of which were made within 2 years of the underpayment. 2/ In Mesa Petroleum Co., 107 IBLA 184 (1989), MMS required restitution of net-downward adjustments of royalty payments taken on Form MMS-2014 because the payor had not filed a refund request under section 10 of the OCSLA. The adjustments were taken in part for overpayments made within 2 years and in part for overpayments made more than 2 years before. Upon the subsequent filing of a refund request, the MMS Director denied the request as to all overpayments made more than 2 years prior to the filing of the request and held offsets could be recognized only in the context of an MMS audit and not where the overpayments had been deducted from subsequently filed royalty reports. The Board upheld the rejection of the refund request as to royalty overpayments made more than 2 years previously without comment regarding the availability of offsets of overpayments against subsequent underpayments within the scope of an audit. 107 IBLA at 190.

We find that Santa Fe and Mesa are distinguished from the present case by the absence of an MMS audit during the term of which the overpayments and underpayments were made. Consistent with the Solicitor's Opinion, supra, and with the Board precedents in Shell Oil Co., supra, and Mobil Oil Corp., supra, we find that this distinction is dispositive. 3/

2/ Although the dates of all the overpayments and the corresponding underpayments in Santa Fe are not set forth in the opinion, those for which dates are given occurred within 2 years. 107 IBLA at 33.

3/ It appears appellants in those cases did not argue, and hence the Board did not consider, whether a recoupment taken on Form MMS-2014 might be sufficiently stated and itemized as to constitute a request for refund which might be allowable to the extent it was filed within 2 years of the overpayment.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the prior decision of the Board is reaffirmed on reconsideration.

C. Randall Grant, Jr.
Administrative Judge

I concur:

Gail M. Frazier
Administrative Judge